interconnection points -- that the provision of such requested unbundled elements and additional points of interconnection is not technically feasible. Assigning the burden of proof in this manner conforms to the dynamic nature of the principles embodied in the Act.[35]

IV. THE COMMISSION SHOULD ADOPT A LONG-RUN INCREMENTAL COST STANDARD FOR THE PRICING OF UNBUNDLED ELEMENTS AND INTERCONNECTION SERVICES.

(Pricing of Interconnection, Collocation and Unbundled Network Elements -- Notice, § II(B)(2)(d))

Section 252(d)(1) of the Communications Act sets forth the relevant pricing standards for unbundled elements and interconnection services. It provides:

> Determinations by a State commission of the just and reasonable rate for the interconnection of facilities and equipment for purposes of subsection (c)(2) of section 251, and the just and reasonable rate for network elements for purposes of subsection (c)(3) of such section —
>
> (A) shall be –
>
> (i) based on the cost (determined without reference to a rate-of-return or other

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35 In determining whether additional unbundling is appropriate, the Commission should consider any lack of demand or the unwillingness of a requesting carrier to commit to the purchase of additional unbundled elements as probative evidence the requested unbundling is not required. In the absence of concrete proof that requesting carriers will actually purchase additional unbundled elements, there is no reason to require incumbent local exchange carriers to engage in the process of defining and then pricing additional unbundled elements. At the same time, incumbent carriers' actions in relation to cost allocation and pricing should be viewed carefully so that unreasonable pricing practices do not foreclose avenues to *bona fide* requesters.

rated-based proceeding) of providing the interconnection or network element (whichever is applicable), and

(ii) nondiscriminatory and

(B) may include a reasonable profit.

On its face, the Act precludes the use of "rate-based" cost-of-service principles and methodologies in establishing rates for interconnection services and unbundled elements. It thereby necessarily precludes the use of embedded costs as the pricing standard.[36] As it should, the Act contemplates the use of a forward-looking costing methodology for the pricing of interconnection services and unbundled elements. As the Commission observes,[37] a number of parties have proposed the use of a TSLIRC methodology for this purpose. TSLIRC fits within the standard the Act sets forth.[38]

Not only does the Act mandate the use of an incremental cost methodology, such an approach is economically correct. Pricing based upon incremental cost sends the correct economic signals that encourage efficient investment and efficient entry,

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36 Traditional cost-of-service regulation provides regulated companies with the opportunity to recover their prudently-incurred expenses plus a reasonable return on investment used and useful (or prudently incurred) in the provision of regulated services. *Cf.* Notice, ¶ 123 (statute appears to preclude "setting rates [based upon] historical carrier costs and rate bases ").

37 *Id.*, ¶ 124.

38 TSLIRC provides "a reasonable allocation of forward-looking joint and common costs" (*id.*, ¶ 129), as well as a competitive level of profit. TSLIRC recovers the cost of the entire service -- *i.e.*, the difference between the future cost of the firm that provides the particular service along with other services, compared to the cost when it does not provide that service, but still provides the same level of its other services.

discourage inefficient investment and inefficient entry and maximize consumer welfare. This approach permits all competitors to face the same economic costs for unbundled elements and interconnection services. All companies may then compete on the basis of their own relative efficiencies.

Pricing exchange access above economic cost has introduced competitive distortions and has retarded growth in the long distance industry. If the Commission fails to adopt an incremental-cost methodology for the pricing of unbundled elements and interconnection points, it will not only continue these existing distortions in this new competitive era, but will also fail to correct existing distortions that inhibit competition in the local exchange. Such a result is, obviously highly undesirable and runs counter to the objectives of the Act.

In contrast to TSLIRC, the alternative pricing proposals set forth in the Notice are not consistent with the Act. Proxy-based outer limits -- maximum, minimum or both[39] -- will result in cost-based rates only by coincidence. Such proxies necessarily fail to recognize cost differences among incumbent exchange carriers. Given the incentives of incumbent local exchange carriers to maintain uneconomically high rate levels and rate relationships that favor their own services, such proxies would likely result in pricing at the ceiling, without regard to the true incremental costs of particular interconnection services or

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[39] *Id.*, ¶¶ 134-43.

unbundled elements. Proxies will also cause rate relationships that bear little resemblance to economic cost. These results are neither consistent with the Act nor well-grounded in economic theory.

There is no basis in the Act for the Commission to utilize existing access charge rules or a subset thereof[40] as the basis for pricing interconnection services or unbundled elements. Even if the carrier common line charge and the transport interconnection charge were excluded from the calculus,[41] the fact remains that access charges far exceed (or at least bear little relationship to) the incremental costs of interconnection and unbundled services. Other proposals -- *e.g.*, reliance on embedded costs, "play or pay" or use of the efficient component pricing rule[42] -- are also inconsistent with the Act for the reason that they do not reflect the incremental costs of providing services today or in the near future. As such, they may not be utilized to establish the prices of interconnection services or unbundled elements under the Act.[43]

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40 *See id.*, ¶¶ 139-41.

41 *See id.*, ¶ ¶ 139-40.

42 *Id.*, ¶¶ 144-48.

43 The Commission also requests comment on certain rate structure issues. *Id.*, ¶¶ 149-54. If the Commission adopts TSLIRC, these issues largely disappear. Use of an incremental cost methodology will ensure that costs are recovered in the manner in which they are incurred and may -- or may not -- justify term or volume discounts for interconnection services or unbundled elements.

V. THE COMMISSION SHOULD ADOPT FEDERAL STANDARDS THAT ENFORCE FULLY THE ACT'S RESALE MANDATE.

(Resale Obligations of Incumbent LECs -- Notice, § II(B)(3))

Resale is a key indicator of the competitiveness of particular industry segments. Markets that are hospitable to resale (the interexchange business, for example) are generally competitive, while those that are not (the local exchange business, in particular) are not.[44] Providing the correct framework for the implementation of the Act's resale provisions is one of the most important duties that the Commission must perform in this rulemaking. Competition in the interexchange business developed to the degree it has today in large part due to the ability of competitors to resell other carrier's services, a direct result of the Commission's pro-resale policies.[45] It was this Commission's forcing resale and arbitrage of steeply-discounted WATS services that primed the competitive pump of long distance competition.

With few exceptions (*e.g.*, Rochester), today's local exchange business has demonstrated a general hostility to the concept of resale.[46] The ability to maintain and institutionalize such hostility provides a clear demonstration that the local exchange

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44 *Id.*, ¶ 171 ("Restrictions and conditions [on resale] [are] likely to be evidence of an exercise of market power").

45 *E.g., Regulatory Policies Concerning Resale and Shared Use of Common Carrier Services and Facilities*, Dkt. 20097, Report and Order, 60 FCC 2d 261 (1976).

46 *E.g.*, US West, Tariff F.C.C. Nos. 3 and 5, Trans. No. 624, DA 95-2064, Order, 10 FCC Rcd. 13208 (Com. Car. Bur. 1995), application for review pending.

business, in general, is far from competitive. Resale prohibitions are a form of first degree price discrimination, where, in effect, an infinite or prohibitive charge is assessed upon resellers. Such discrimination is only sustainable in a non-competitive environment.[47] Frontier's own resale and telemanagement operations have certainly learned this lesson. On the eve of the Act's enactment, US West attempted to refuse to continue to sell Centrex service to resellers due, in large part, to a fear of such competition through resale.[48]

The Act provides the statutory basis to cure this resale prohibition problem. To achieve the Act's pro-resale philosophy, the Commission must follow through with enforceable national regulations implementing the Act's mandates. The requirements of the Act are simple. Under section 251(c)(4), incumbent local exchange carriers have:

> the duty —
>
> (A) to offer for resale at wholesale rates *any* telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers; and
>
> (B) not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of such telecommunications service ...[49]

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47 Pindych & Rubenfeld, *Microeconomics* at 370-76 (2d ed. 1992).

48 *See Enhanced TeleManagement, Inc. v. US West Communications, Inc.*, File No. E-96-23, Complaint (Feb 22, 1996).

49 47 U.S.C. § 251(c)(4) (emphasis added).

In addition, section 252(d)(3) establishes the relevant pricing standard:

> For the purposes of section 251(c)(4), a State commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to *any* marketing, billing, collection and other costs that *will be avoided* by the local exchange carrier.[50]

The Commission should establish standards to implement the Act's mandates in both respects. *First*, the Commission should make clear that the Act means what it says -- *all* services offered at retail *shall* be available for resale. The Act admits of no exceptions.[51] This clear duty imposes at least two -- albeit extremely significant -- corollary obligations on incumbent local exchange carriers.

(A) Service quality and provisioning provided to an incumbent local exchange carrier's resale customers must be equal in type and quality to that provided to that exchange carrier's own end-user customers. In particular, network quality (probability of blocking, switch down-time, transmission quality) must not differ depending upon the identity of the end-user's service provider. The incumbent local exchange carrier, after all, is physically providing the network facilities directly to the end-user in both cases.

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50 47 U.S.C. § 252(d)(3) (emphasis added)

51 Although the Act does allow for some limits on the resale between certain classes of *end users* for certain resold services (47 U.S.C. § 251(c)(4)(B)), all services may be resold.

With respect to administrative functions that involve some interface between the reseller and the incumbent local exchange carrier (*e.g.*, service order processing), the interval between when the incumbent local exchange carrier receives and processes an order must be equal as between orders submitted by a resale customer and by an end-user customer. The rules should also require incumbent local exchange carriers to provide billing and related information in a timely and efficient manner to allow resellers to provide local billing that is coordinated with their charges for long distance and other services [52]

In a resale environment, the incumbent local exchange carrier not only has the incentive -- but also the clear ability, because it is providing the underlying network facilities -- to provide substandard service to its resale customers. In this manner, end-user customers will perceive the incumbent's services as superior to those of its resale customers. This result is not only anticompetitive, it would undermine the Act's resale mandates. To help alleviate this concern, the Commission should adopt an "equal in type and quality" standard and provide the monitoring tools necessary to enforce this requirement.[53]

(B) The Commission must also address issues regarding new and discontinued services. The Act requires that *all* retail services be available for resale. Without a

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52 For example, daily CDR updates are essential if the reseller is to be able to bill its customers on a timely basis. Daily CDRs also reduce the "float," thus increasing the avoided costs of resale for the local exchange carrier

53 *See supra* at 17-19.

mandate barring prohibitions on resale, an incumbent exchange carrier could frustrate the Act's resale policy by migrating end users to "non-resellable," new services. The Commission should make clear that the Act's resale mandate includes new services. Thus, the Commission should establish a rule that any new (or existing) retail services that an incumbent local exchange carrier offers must automatically be made available for resale in accordance with the Act's pricing requirements.[54]

The Commission must also adopt regulations that preclude incumbent local exchange carriers from unilaterally withdrawing from service existing retail offerings that resale customers offer to the public. US West's attempts to eliminate its Centrex offerings demonstrate the necessity for such a rule. Such actions -- if permitted to become effective -- would effectively cripple local exchange resale and severely retard the development of competition. To prevent such an outcome, the Commission should establish national regulations -- enforceable through the section 208 complaint process on an expedited basis -- that preclude incumbent local exchange carriers from discontinuing a service unless that service has no customers or there are available less expensive alternatives to which all that service's customers may be migrated voluntarily. Requests to withdraw

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[54] For purpose of defining what constitutes a new service, the Commission should rely upon its existing price cap new services rules. *Policy and Rules Concerning Rates for Dominant Carriers*, CC Dkt. 87-313, Second Report and Order, 5 FCC Rcd. 6786, 6824, ¶ 314 (1990), *aff'd sub nom. Nat'l Rural Telecom Ass'n v. FCC*, 988 F.2d 174 (D.C. Cir 1993). Thus, any service that expands the range of options available to consumers -- including term and volume discounts -- would qualify as a new service that must be made available for resale at wholesale rates.

qualifying existing services should be made on lengthened notice periods and subject to the heightened public interest standard described above.[55]

Second, the Commission should adopt regulations implementing the Act's avoidable cost standard. The Act's "retail price minus costs that will be avoided" standard is clear. The Act presumes that retail costs are taken as a given. The wholesale rate is then derived by subtracting from retail prices those costs that an incumbent local exchange carriers would not incur by offering services on a wholesale -- rather than a retail -- basis. That is, costs that an incumbent local exchange carrier will not incur by offering services on a wholesale basis may not be reflected in wholesale rates.

The Commission asks whether -- as a result of the interplay of the pricing rules governing unbundled elements and interconnection services, on the one hand, and resold services, on the other -- it should adopt a rule that "the sum of the parts may not exceed the whole."[56] In general, the Commission should adopt such a rule. This rule is necessary to prevent price squeezes that could otherwise occur as a result of differences between the prices for individual unbundled elements and resold services.

However, in the case of subsidized services, the Commission should adopt a modified standard to compensate for the existence of the subsidy. Thus, the Commission could allow a limited offset for the subsidy to assure that unbundled elements and

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55 *See* Notice, ¶ 175.

56 *Id.*, ¶¶ 184-88.

interconnection services are priced at cost.[57] In this context, the Commission should adopt a standard that the sum of the parts may not exceed the subsidized whole (*i.e.*, retail rate), plus the amount of the subsidy (*i.e.*, incremental cost less the retail rate). This approach will take the existence of a subsidy into account, yet will also help prevent the potential for uneconomic price squeezes.

Indeed, this situation underscores the need that *all* telecommunications services must be priced at cost. Services that are priced above cost must experience price decreases, while services that are priced below cost must experience price increases. Such an outcome is fully consistent with economic principles and with the Act's mandates.[58]

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[57] It is not likely that broad classes of service are universally priced below their incremental costs and, therefore, are subsidized. The Washington Commission, for example, recently concluded that an average residential rate of $10.50 per month covers US West's incremental cost of service. *See* Dkt. UT-950200, Fifteenth Supplemental Order at 96-97 (April 1996), *appeal pending*. Thus, this modified rule should be applied narrowly and the Commission should place the burden of proof on an incumbent exchange carrier seeking to avail itself of this rule to demonstrate that the affected class of service is, in fact, priced below its forward-looking incremental cost (*i.e.*, subsidized).

To the extent that rates for certain classes of service are, in fact, below cost, the affected commissions should permit incumbent exchange carriers to rebalance their rates to cure this situation. *See also infra* at 31.

[58] This outcome is also not particularly undesirable. The same objection was raised by previously-favored customer classes that were affected by the implementation of the Commission's access charge regime. The D.C. Circuit answered these claims succinctly:

> Woven into ARINC's brief is the theme that, somehow, airlines are different. But, so far as this appeal is concerned, they are not. ARINC could not seriously argue that the impact upon a single industry of the FCC's vast and ambitious reworking of the communications industry's

For example, as Frontier suggested in its comments in CC Docket 96-45,[59] the Commission may materially assist in aligning prices to cost by permitting end user common line charges to increase. Such charges have not increased since the initial transition ended. In real terms, then, they have actually declined, eroding the economic balance sought to be achieved more than ten years ago. The presence of such charges has had *no* impact on universal service. Even by permitting end user common line charges to increase by the rate of inflation since the end of the transition would help substantially reduce carrier access charges from their current levels to levels more in line with economic costs.[60]

> rate structure could in any way affect the outcome of our review. There are winners and losers galore as a result of the FCC's plan which will eventually place the cost of services provided upon those who use the facilities.

Nat'l Ass'n of Reg. Util. Comm'rs v. FCC, 737 F.2d 1095, 1147 (D.C. Cir. 1984).

59 *Federal-State Joint Board on Universal Service*, CC Dkt. 96-45, Comments of Frontier Corporation at 11 n.23 (April 11, 1996).

60 Indeed, AT&T has suggested that the end user common line charge be increased to seven dollars per month. *See Federal-State Joint Board on Universal Service*, CC Dkt. 96-45, Comments of AT&T Corp. at 15-17 (April 12, 1996).

VI. THE COMMISSION SHOULD ADOPT BASELINE MUTUAL COMPENSATION REGULATIONS THAT IMPLEMENT THE ACT'S REQUIREMENTS.

(Reciprocal Compensation for Transport and Termination of Traffic -- Notice, § II(B)(5))

The Act requires that telecommunications carriers compensate each other for the transport and termination of telecommunications on the basis of "a reasonable approximation of the additional costs of terminating such calls."[61]

The reciprocal compensation obligation is not inconsistent with the unbundling and interconnection obligations of the Act.[62] Rather, this obligation applies where one carrier terminates traffic on another carrier's network (*e.g.*, commercial mobile radio service to wireline traffic) using facilities that the first carrier has not purchased on an unbundled basis. In this network configuration, the Act requires that compensation be based upon the "additional costs" of terminating calls. This requirement precludes this Commission (or any State commission) from adopting a bill-and-keep approach to mutual compensation unless it can be shown that no additional costs exist.[63] As Frontier sets forth in more detail in its

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61 47 U.S.C. §§ 251(b)(4), 252(d)(2)(a)(ii)

62 *See* Notice, ¶¶ 232-33.

63 The Act provides (47 U.S.C. § 252(d)(2)(B)(i)), that such arrangements may be arrived at through the negotiation and arbitration process by the "waive[r] [of] mutual compensation." This might make sense to the negotiating parties where the "additional costs" are offset by the transaction costs.

comments in CC Docket 95-185,[64] the Commission should adopt a reciprocal and mutual compensation standard based upon the incumbent local exchange carrier's incremental cost of terminating traffic.[65]

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64 *Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Dkt. 95-185, Comments of Frontier Corporation at 8-9 (March 4, 1996).

65 To the extent that either carrier purchases unbundled elements and interconnection from the other to perform this terminating functionality, mutual compensation obligations would not apply to the costs of carrying traffic already covered by applicable charges for unbundled elements and interconnection.

Conclusion

For the foregoing reasons, the Commission should act upon the proposals contained in the Notice in the manner suggested herein.

Respectfully submitted,

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